Working Capital Management and Financial Performance of Selected Consumer Goods in Nigeria

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Abstract

This study examines the relationship between the management of working capital and company performance of selected consumer goods in Nigeria. The research study adopts an ex-post facto research design. Purposive and convenience sampling techniques were adopted to select ten companies out of the fifteen companies quoted on the Nigerian Stock Exchange as at 31st December 2018. The data were analyzed quantitatively using descriptive and inferential statistics in form multiple regression analysis. Findings revealed that the average collection period has a positive and significant relationship with return on assets of the selected consumer goods in Nigeria. Likewise, inventory turnover in days is found to relate with return on equity and the cash conversion cycle is significantly related to return on sales of selected consumer goods in Nigeria respectively. The study concludes that the management of working capital has a significant impact on company performance of selected consumer goods in Nigeria. Therefore, it is recommended that consumer goods in Nigeria should pay more attention to the management of their working capital since they positively influence profitability.

Keywords: Consumer goods, Financial performance, Manufacturing companies, Working capital, Working capital management,

Introduction

The Nigeria manufacturing sector has enticed so many investors since independence in 1960 due to its performance and potential for speedy economic growth which is characterized by its population (Banjoko, Iwuii and Bagshaw, 2012). A manufacturing sector that is growing has the capacity of reducing poverty through the generation of employment and the creation of wealth. In spite of these potentials, there has been a consistent decline in the performance of the sector over the years. This trend of downward decline has been noticed since the early 1980s (Manufacturing Association of Nigeria 2014).

There are several factors bedeviling the Nigerian economy, these factors include corruption, bad governance, lack of policy implementation and unfavorable competition prevent the manufacturing companies to achieve maximum return on their resources and investments (Eya, 2016). The ability of a company to sustain its undertakings depends largely on its efficient and effective utilization and management of its finance (Karaduman, 2011). Therefore, efficient capital management and proper planning are required to manage the manufacturing sector, as the most competitive industry in Nigeria. Working capital is seen globally as the most vital tool to properly manage if at all a company wants to survive in an industry (Owolabi and Alu, 2012). More so, Owolabi and Alu (2012) further argue that working capital is an important element that requires proper planning, management and maximum attention in any manufacturing organization. Since there is a scarcity of any resource available to any organization, it is of paramount importance that this resource is managed properly in order to achieve the organization's profitability and its overall performance (David, 2010).

Working capital implies the company's funds that are tied up in materials, receivables, cash, finished goods and work-in-progress. In addition, Khan and Jain (2007) defined current assets as those assets that are convertible into cash within a short period, and the cash received is again reinvested into the above-mentioned assets, therefore, it is consistently circulating or

receiving. Hence, the financial position of a company is measured mostly with working capital which as opined by (Guthmann, 2008) is the nerve center and lifeblood of any business organization. Therefore, working capital management is a necessity that every business organization must have if it must achieve its values and maximum objectives.

However, economic activities in the country are being stabilized by the manufacturing sector which also serves as a mechanism for achieving growth and development in terms of export, employment generation, foreign exchange earnings and overall performance of the economy. Salawu and Alao (2014) observed that the manufacturing sector contributed between 11% and 9.9% in the 1970s and 80s respectively to the Gross Domestic Product (GDP) of the nation. Consequently, the contribution of the sector to the nation's GDP started dwindling due to mismanagement of working capital, which eventually led to the folding up of many manufacturing companies, resulting in the importation of commodities that should have been manufactured locally (Manufacturing Association of Nigeria 2014).

Presently in Nigeria, manufacturing companies are operating under hostile conditions, ranging from poor infrastructural facilities such as electricity and pipe-borne water, high-interest rates on banks' loans, access to capital and problem of security which continue to impede the growth of the economy (Eya, 2016). However, in the face of the above-mentioned challenges and constraints, companies have improvised means of generating their power and accessing funds to boost their working capital by improving productivity to meet the requirements of their customers.

Hence, there is the need for efficient management of working capital which involves financing and control of current assets and currents liabilities of the companies. The largest part of an investment of manufacturing companies is tied up in their working capital which is due to their functions and nature of operations. Therefore, the success of the companies largely depends on the proper management of their working capital and financing (Kehinde, 2011).

The aim of this study is to examine the impact of working capital management on the performance of selected consumer goods in Nigeria. To come up with facts that establish the relationships that exist between some components of working capital and performance measurements of selected consumer goods manufacturing companies, and to provide information that will be useful for the better management of manufacturing companies in Nigeria.

This study will consider the main variables of working capital that can influence the performance of consumer goods in Nigeria. Working capital management is measured in this study using Average Collection Period (ACP), Inventory Turnover in Days (ITID), and Cash Conversion Cycle (CCC), while financial performance is measured with return on assets, return on equity, and return on sales. The choice of these variables is being influenced by previous studies conducted by different researchers on working capital management.

Problem Statement

The profitability of many consumer goods listed on the Nigerian Stock Exchange has been affected by the global economic meltdown of late 2000. Hence, many of the companies are merely struggling to stay alive in the capital market. Furthermore, the hostile environment in which these companies find themselves and operate is really affecting their efforts towards profit maximization. In spite of these circumstances, maximum attention should be given to the management of working capital, if the companies really want to survive. Al Shubiri (2011) opines that as blood circulation is vital in the human body to sustain life, so is the flow of funds to sustain business undertakings. The business can hardly prosper if the supply of funds is not adequately met. Enyi (2011) emphasizes further by asserting that business is as strong as its

capital base, as liquid as the volume of its working capital and as viable and dynamic as its managerial decisions. Therefore, the center of existence of any business is its working capital. As a matter of fact, businesses cannot operate successfully without the management of working capital (Eya, 2016).

Osundina (2014) and Ezejiofor *et al* (2015) found in their studies that consumer goods in Nigeria are facing difficulties with their payment and collection policies as well as not managing their inventory levels. These problems have affected negatively the profits and values of the companies. The studies of Nwankwo and Osho, (2010); Egbide (2009) revealed that the improper management of working capital has resulted in a loss of profit due to bad debts, inability to expand, under/overstocking and vulnerability to liquidation and insolvency. In the same vein, Eya (2016) opines that valuable staff of consumer goods in Nigeria has been lost, whereas the few ones that are left are not working cooperatively with each other, the situation that makes it difficult to achieve overall goals and objectives of the organizations.

Onwumere and Mmesirionye (2015) highlighted the problems associated with poor financial performance and management of working capital of foods and beverages manufacturing sector of Nigeria as largely due to the incompetence of the finance manager to decide on favorable sources of financing working capital, management of the working capital, unstable political and economic policies foreign exchange volatility that are capable of affecting profitability and liquidity. Takon and Atseye (2015) observed in their studies that most of the material inputs being utilized by manufacturing companies in Nigeria are imported, as this affects the monetary policies of the government and foreign exchange earnings.

Having highlighted the problem above, the researcher wishes to conduct this study to establish the relationships that exist between the dependent variable and the independent variable already mentioned in the introduction.

Objectives of the Study

The main objective of this study is to examine the relationship between working capital management and organizational performance of selected consumer goods in Nigeria. The specific objectives are:

i. To examine the influence of inventory turnover in days on return on equity of selected consumer goods in Nigeria;
ii. To determine the effect of the average collection period on return on assets of selected consumer goods in Nigeria;
iii. To assess the effect of the cash conversion cycle on the return on sales of selected consumer goods in Nigeria and

Hypotheses

The following hypotheses are tested.

H_1 There is a significant relationship between inventor turnover in days and return on equity of selected consumer goods in Nigeria.

H_2 There is a significant relationship between the average collection period and return on assets of selected consumer goods in Nigeria.

H_3 There is a significant relationship between the cash conversion cycle and return on sales of selected consumer goods in Nigeria.

Literature Review

Working Capital

Ashiq (2011) is of the opinion that working capital is financed through a mixture of short-term and long-term funds. Cyprian and Tobias (2014) defined working capital as the monies that are tied up in finished goods, work-in-progress, prepayments and receivables. To them, working capital is capital investments tied up in current assets which are assets that can be reconverted into cash within a short-term period, and the cash generated can also be reinvested into assets. The excess of current assets that are not supplied by either the shareholders or the creditors is referred to as working capital (Snober, 2014; Ikpefan and Owolabi, 2014).

Though, there are two types of working capital; gross working capital and net working capital. Gross working capital refers to the investment of funds made in current assets that are used by the business, whereas the networking capital reflects the difference between current liabilities and current assets (Cyprian and Tobias, 2014). Current assets may include work-in-progress, inventories of raw materials and finished goods, cash, trade receivables, prepayments and short-term investments, while current liabilities include short-term loans and overdrafts, trade payables and accruals. Therefore, working capital can finally be viewed as the equilibrium that exists between resource-purchasing activities and the liquidity position of a firm (Zdenek and Dana, 2014).

Working Capital Management

Li and Han-Wen (2006) see working capital management as the application of strategies and sound policies in the utilization of current assets and current liabilities in order to ensure that optimum level is maintained of working capital. The main objective of maintaining working capital is to achieve profitability and maximize stockholders' value through sales.

However, a sale does not translate into cash immediately, the time between acquiring raw materials for production and turning them into cash is called a working capital cycle or operating cycle. Hence, working capital management involves the acts of planning, controlling and organizing the components of working capital such as inventory, cash, receivables, bank balance, payables, short-term loans and overdrafts (Paramasiyan & Subramanian, 2009). For Mian and Talat (2010) working capital management is how all the aspects of current liabilities and current assets are administered in any business organization.

Average Collection Period

The average collection period (ACP) is approximately the time taken by a business to receive payments from its debtors (Mathuva, 2010). This is an independent variable that is a proxy of the collection policy. It is measured by dividing receivables by net credit sales and multiplying it with 365 as in the number of days in a year. The ACP is the number of days on average between the days that credit sales are made and the days that monies are received from customers. It can also be measured as the average account receivables divided by average credit sales per day.

Furthermore, ACP measures the average number of days it will take a business to receive payments from customers for the sales it made on credit (Mekonnen and Worku, 2011). Many businesses allow customers to takes goods or commodities on credit which are to be paid later, mostly within 30 days. These kinds of payments are referred to as account receivables.

Inventory Turnover in Days

Inventory is viewed as one of the most important components of a business. Businesses are expected to keep track of the duration it will take to transform inventory into cash due to its effect on performance (Mekonnen and Worku, 2011). Most companies use inventory turnover

as a means of measuring performance over a certain period and also as a means of comparison among companies operating in the same industry, to ascertain the time it takes to sell products and ways of enhancing profitability and efficiency. Inventory turnover ratio is an efficiency ratio that depicts effectively how the management of inventory is done by comparing the cost of sales with average inventory for the period (Goldman *et al*, 2005).

Average Payment Period

The time it takes a company to pay its creditors for goods supplied on credit is referred to as the Average Payment Period (APP). Likewise, Deloof (2003) opined that business can assess better the quality of goods bought on credit from suppliers by delaying their payments, and as well, the cash which would have been used to pay them can be channeled into other operations that maximize profits. Consequently, Padachi (2006) argued that if a trade discount for paying early is involved, delaying payments might be costly to the business and also its credit reputation in the long-run may be jeopardized.

As such, APP is a measure of short-term liquidity that explains the rate at which the suppliers of the company are paid off (Afeef, 2011). It is an independent variable used as a proxy for payment policy. It is measured by dividing account payables with purchases and multiplying it with 365.

Cash Conversion Cycle

Cash conversion cycle (CCC) is viewed as the length of time it takes a company, from payment of raw materials acquired to produced goods until the receipt of account receivables in form of cash in respect of the goods sold (Besley and Brigham, 2005). A CCC that is short may be associated with a higher profit due to the efficient utilization of working capital. Schiff and Lieber (2009) defined CCC as a composition matrix that describes the average number of days that is required to convert the value of naira invested into raw materials and the naira value that will be collected from customers.

Company Performance

Iswatia and Anshoria (2007) defined performance as the ability of any business organization to successfully manage its resources using several means in order to achieve a competitive advantage in the industry. There are two types of performance; financial performance and non-financial performance. The financial performance emphasizes on the variables that are found directly in the financial statements or reports of the companies.

Return on Assets

This is an important ratio that determines if a company should embark on a new project or not. The ratio allows the company to ascertain the project it will invest in to generate profit, i.e., if ROA is more than what a company can borrow, the project should be accepted, if otherwise, it should be rejected. Shin and Soenen (2010) assert that companies with higher ROA have effective management of working capital as they dominate the market and possess bargaining power over customers and suppliers. Also, Popoola (2012) observed that companies with high ROA receive more credits from their suppliers. ROA is measured by earnings before interest and tax over total assets.

Return on Equity

The percentage of profit a company makes for any monetary unit of equity it invests is called Return On Equity (ROE). Although, how much cash that will be returned to stockholders is not specified because it is a decision of the company on how dividends should be paid and how much the prices of stocks appreciate. However, the sign that the company is able to generate a return is worth taking the risk to invest (Berman and Slobin, 2013). ROE is measured by dividing net profit by average stockholders' equity.

Return on Investment

Return on investment (ROI) is a measure of performance that is used to estimate the efficiency of an investment or to make a comparison in terms of efficiency among different kinds of investments (Kehinde, 2011). To measure ROI, the benefit or return derived from the investment is divided by the cost of the investment, which is later expressed as a ratio or percentage. ROI ratio is used in manufacturing companies by financial analysts to determine the best plans of investment (Henke *et al*, 2011). Shareholders and investors also use it to make investment decisions.

Return on Sales

Return on sales (ROS) is the ratio that measures the rate at which companies benefit from their revenues (Lawrence, 2015). The higher the ROS ratio of a company, the higher the rate of its sales, translating into its sustainability. But when the sales volume is low, the opposite is the case. ROS also called operating profit margin, is a financial ratio that measures the efficiency of companies in terms of the profits they generate from their revenues. Okere (2012) asserts that it measures the performance of a company by analyzing the percentage of the total revenue of a company and how it translates into profit. Shareholders and creditors show much interest in this ratio because it avails them with the actual money that the company made at the end of the period.

Theoretical Framework

This study is anchored on two theories, the resource-dependency theory and cash conversion cycle theory. The resource-dependency theory centered on the dependent variable which is organizational performance, while the cash conversion cycle (CCC) theory explains the independent variable, which is working capital management. The CCC is a very important component of working capital management and financial management because it directly affects the liquidity and profitability of the company. It deals with current assets and current liabilities which constituted the independent variables in this study.

Materials and Methods

A secondary source of data was employed for this study, using financial and statistical formulae as methods to arrive at the figures for the statistical computation and analysis. The data for this study were sourced from ten sampled consumer goods listed on the Nigerian Stock Exchange for a period of five years (2014 – 2018). Based on this research, purposive sampling technique is used. Purposive sampling was used by the researchers to select the ten companies adopted in this study.

Time series data of return on asset, return on equity, return on investment and return on sales were sourced from the published annual reports of companies concerned. Other secondary data and financial reports were also extracted from fact-book, websites, and Nigeria stock Exchange. The justification for the use of secondary data is based on the reason that this study is quantitative research, which tried to find out an aftermath effect, as such data that are historical in nature were analyzed. In addition, previous researchers such as Falope and Ajilore, (2009); Mathuva (2010); and Akinlo (2011), on working capital management and firm's performance had equally made use of secondary data because of the reliability of such data.

Regression Analysis

Panel regression analysis was used to explain the change in the value of dependent variables on the basis of changes in other variables known as the independent variables using panel pooled data (that is, a combination of cross-sectional and time-series data). The panel regression equation took the following form based on the hypotheses formulated:

$ROEit = \beta0 + \beta1ITIDit + \varepsilon it$ …… (equation i)
$ROAit = \beta0 + \beta1ACPit + \varepsilon it$ …… (equation ii)
$ROSit = \beta0 + \beta1CCCit + \varepsilon it$ …… (equation iii)
Where:
ROEit = Return on equity for the company i at the end of year t.
ITIDit = Inventory turnover in days for the company i at the end of year t.
ROAit = Return on assets for the company i at the end of year t.
ACPit = Average collection period for the company i at the end of year t.
ROSit = Return on sales for the company i at the end of year t.
CCCit = Cash conversion cycle for the company i at the end of year t.
$\beta0$ = The intercept of the regression line.
εit = Error term over cross-section and time.

Results of the Findings

Table 1: Panel regression result based on Return on Equity

Variable	Pooled (OLS) Coefficient (P-value)	Fixed Effect Coefficient (P-value)	Random Effect Coefficient (P-value)
ITID	0.2645(0.540)	0.6259(0.331)	0.6324(0.3489)
R-sq	0.45341	0.39738	0.621985
Prob(F-stat)	0.000678	0.004121	0.001878

Note: *, **, and *** signifies 10%, 5% and 1% respectively

The first objective of the study was to establish the influence of inventory turnover in days on return on equity of selected consumer goods in Nigeria. The results revealed inventory turnover in days does influence return on equity of selected consumer goods in Nigeria. The finding is consistent with the works of Akinlo (2011), Mathuva (2010) that there is a positive relationship between inventory conversion period and profitability. The study also provides evidence to infer that the Inventory in manufacturing firms is inevitable, and it must be properly managed. The number of days it takes a firm to turnover its stocks is germane to its success. Ideally, the shorter a firm's inventory conversion period, the more profit the firm makes because a short inventory conversion period will lead to high turnover which will eventually lead to high profit. In a firm where there is a positive relationship between inventory conversion period and profitability, there is a possibility of having idle stock which will eventually have a negative effect on the firm's profitability.

Table 2: Panel regression result based on Return on Asset

Variable	Pooled (OLS) Coefficient (P-value)	Fixed Effect Coefficient (P-value)	Random Effect Coefficient (P-value)
ACP	0.10828(0.040)**	0.07955(0.031)**	0.07708(0.0489)**
R-sq	0.551518	0.455438	0.641975
Prob(F-stat)	0.003558	0.036431	0.000373

Note: *, **, and *** signifies 10%, 5% and 1% respectively

Discussion

The second objective of the study was to establish the effect of the average collection period on return on assets of selected consumer goods manufacturing firms in Nigeria. The finding of this study has revealed that the average collection period has a significant effect on the return on assets of selected consumer goods in Nigeria. The finding agrees with those of Kimeli (2012), whose finding revealed that the gross operating profit of manufacturing firms in Kenya was positively correlated with the average collection period. Eya (2016) study on the impact of working capital management on profitability supported the result. They discovered that

management of inventory, receivables and payables had a direct influence on a company's cash flows which could ultimately affect its profitability.

Table 3: Panel regression result based on Return on Sales

Variable	Pooled (OLS) Coefficient (P-value)	Fixed Effect Coefficient (P-value)	Random Effect Coefficient (P-value)
CCC	0.10828(0.040)**	0.074325(0.031)**	0.02709(0.0189) **
R-sq	0.591518	0.515438	0.654375
Prob(F-stat)	0.00528	0.054343	0.00363

Note: *, **, and *** signifies 10%, 5% and 1% respectively

The finding of hypothesis three revealed that the cash conversion cycle has a significant effect on return on sales of selected consumer goods in Nigeria. The finding is consistent with the Cash Conversion Cycle (CCC) Theory which is used to determine the amount of cash needed for any sales level. The cash conversion cycle is used as a comprehensive measure of working capital as it shows the time lag between expenditure for the purchase of raw materials and the collection of sales of finished goods (Padachi, 2006). The CCC theory argued that a longer cash conversion cycle might indicate that a company's sales are rising and that the company can compete by having lax credit policies or high inventories. But on the contrary, a higher CCC can actually hurt a company's profitability by increasing the time that cash is tied to non-interest-bearing accounts such as accounts receivables. By shortening the CCC, the company's cash flows will have a higher net present value because cash is received quicker. The number of days, account receivables; inventories and accounts payables are used as the operationalization of the management of trade credit and inventory (Sharma and Kumar, 2011).

Conclusion

This research investigated the effect of working capital management on company performance of selected consumer goods in Nigeria. Working capital refers to the management of current assets and current liabilities. Working capital is the flow of readily available funds necessarily required for the continuous operations of an enterprise. Working capital management, therefore, is a process of determining the firms' policy in planning for its current assets and liabilities holdings in financing its routine operations. Working capital management concerns primarily with the management of current assets and by extension the current liabilities of a business. Poor management is the main reason for business failure as many corporate organizations went into liquidation in Nigeria because of poor management. Thus, for manufacturing operations to be run effectively and efficiently, optimum cash management techniques must be adopted as cash shortage can disrupt the firm's manufacturing operation, while excessive cash can simply remain idle, without contributing anything in terms of return towards the firm's profitability.

In lieu of that, this study concludes that working capital management has a significant effect on the organizational performance of selected consumer goods in Nigeria. The study further concludes that the shorter the cash conversion cycle, the more efficiently cash is managed and ultimately the more profitable the firm as less borrowing cost is involved. On the other hand, the longer the cash conversion cycle, the less cash is available and ultimately decreasing profitability due to increased borrowing cost.

Recommendations

Based on the findings of this study, the following recommendations are suggested:

Manufacturing companies should pay attention to the sound management of their working capital components since the results show that they do affect profitability. The managers of selected consumer goods should enhance performance by reducing the number of days in which

inventories, cash conversion cycle, and net trading cycles are achieved to a reasonable minimum. This can be accomplished by improving the inventory control process. The managers of selected consumer goods should maintain a more restrictive credit policy as well as good corporate governance be entrenched in their overall operations. Accounts receivable should be collected more quickly by improving the efficiency of the collection process as debt should be collected in line with the agreed credit terms.

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